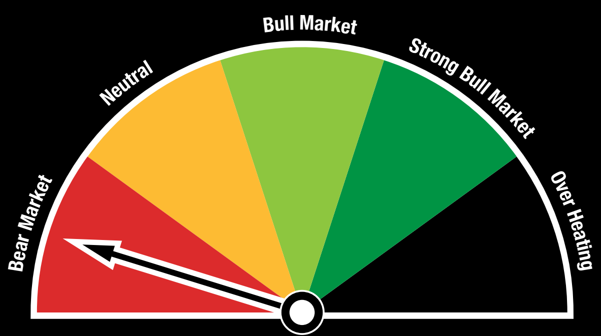
Atlas Pulse

See the facts, trade the action, ignore the noise

Gold



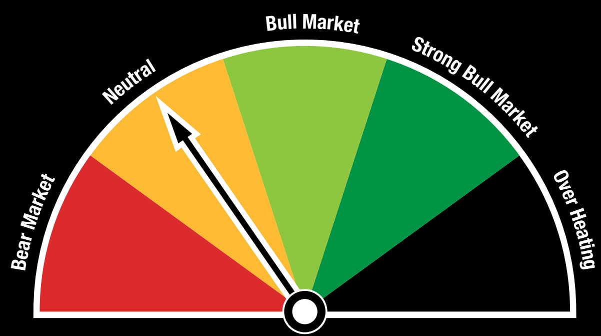
Gold Thermometer

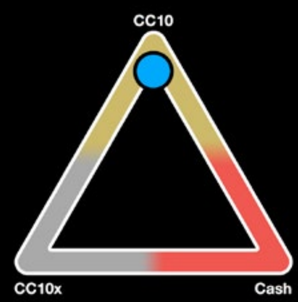
The Gold Thermometer translates the various trading signals into an overall reading of the markets, enabling investors to increase gold investments in Bull markets and reduce them in Bear and Over-heating markets.

Gold Triangle

The Golden Triangle shows that the Atlas Pulse relative view. Given our cautious stance, stick with the relative safety of gold.

Crypto





Recent recommendations

Gold:

Jan 2013 downgrade to ‘bull market’ at $1,675
Feb 2013 downgrade to ‘neutral’ at $1,663
May 2013 downgrade to ‘bear market’ at $1,476
July 2013 bear market rally with range $1,180 to $1,400
Nov 2013 expect new lows into 2014
Sep 2014 silver smash
Dec 2014 bear market rally, $1,350 is possibe

Crypto:

Dec 2013 initiating coverage
Mar 2014 buy Bitcoin
Oct 2014 thermometer begins at neutral

December 2014

- Gold Yen breakout
- Buy the miners
- Core gold models
- Short-term technicals
- COT, flows and 3x
- A multi-blockchain world
- A coloured coin transaction
- Network statistics

Gold Yen breakout

Last month the gold price made a new low following 18 months in a trading range. Pundits, including Atlas Pulse, cried out that $1,000 was close at hand. Many of the former bulls turned into bears and, for once, the gold bugs went quiet. One thing I love about financial markets is that however hard you try to fight it, the majority is always wrong at the extremes. Just as the crowd saw $1,000 as a certainty, gold bounced. I then released a brief bullish statement by email to subscribers for a bear rally 'that would test $1,350'.

My preference was for the miners. No sooner than I had done that, gold crashed again only to have a strong bullish reversal on Monday 1st December. As I write silver has enjoyed its fifth largest intraday move in 20 years. Don't fight it. Volatility swings like this tend to mark major turning points.

Russia sucked up the ETF gold sales in November. Quite wisely, they knew the Rouble would continue to fall and so gold looked like a good bet for them. But along those same lines, many currencies started to resemble the Rouble. The Yen, for example, driven by a dose of QE, fell point for point with the gold price only to break out on Friday 14th November. The following week, gold bottomed in Euros and Pounds and so the bear story was only visible in dollar terms. Gold then only made a new low in dollars, so this bear move was more a reflection of dollar strength than gold weakness.

Gold in Yen – past year

Source Bloomberg

Chart note: *The gold price in Yen had been pretty flat, but finally broke upwards in the middle of the month. Strength started to appear in other currencies. In other words, gold was stronger than most currencies but weaker than the almighty dollar. The longer-term gold yen chart is in a squeeze pattern; a mark of extremely low volatility. It hasn't yet broken out on this basis, but will before too long in one direction or the other. The short-term chart is looking good.*

Buy the miners

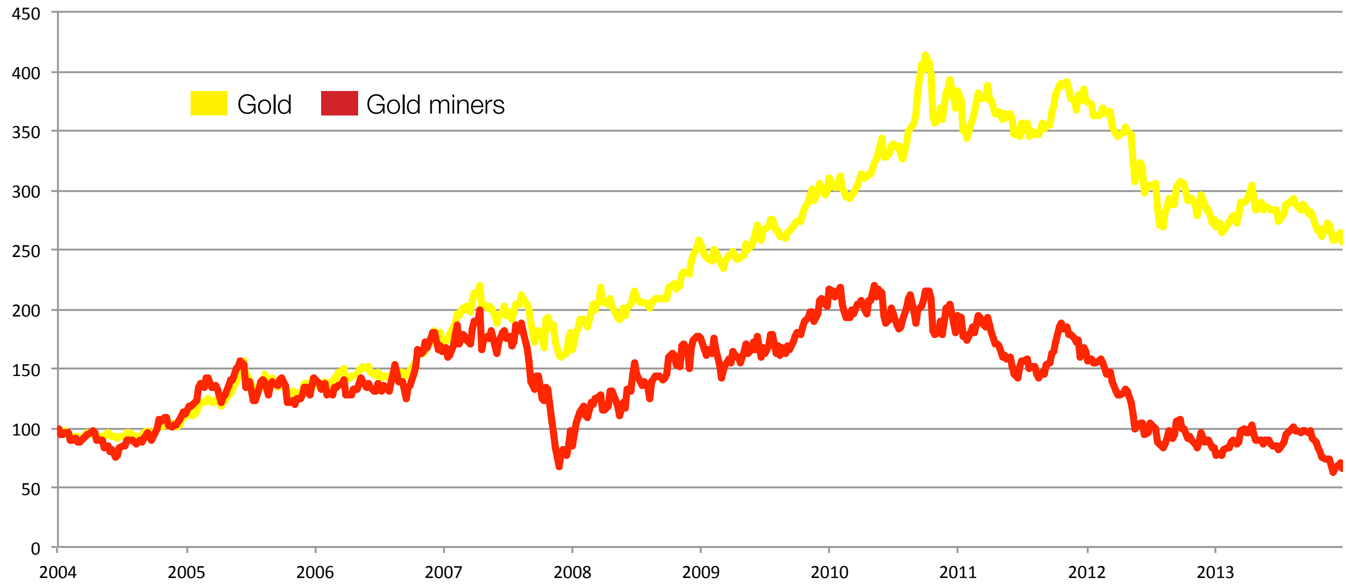
I've been saying for a while that the miners offer value on a five-year view, but that they would fall regardless if the gold price continues to weaken. The Yen gold move urged me to consider that gold mining shares were collectively too low for the prevailing gold price. There was a trend change from a deeply oversold position and so I released an email to subscribers on 22nd November stating just that.

Feel free to follow me on Twitter @atlaspulse for occasional updates. I tend to tweet more about bitcoin than gold. In part, that's because the gold people on Twitter are generally nuts. Mind you, so are the Bitcoiners. Maybe I'm nuts too.

The key point is that the miners are trading at levels last seen at the depths of 2008, however this time, the gold price is 50% higher. With oil at $67, it's hardly a boon for inflation, but oil accounts for approximately a third of the miners' cost base. They are generally tied into long-term contracts, but at the margin, cheaper oil isn't necessarily good for gold, but it's good for the miners' long-term costs. When I then looked at three decades of oil versus gold, $1,170 and $67, oil is now 10% cheap versus gold having been 30% expensive at the beginning of this year.

In other words, lower oil, as a commodity comparison, has 'caught down' with gold. If oil continues to fall, that could have bearish connotations for gold over the medium-term, but right here and right now, oil has finally snapped in line with other commodities. After all, and as I highlighted some months ago, the speculative longs in the oil market were off the scale. Traders have been unwinding these positions at breakneck speed.

The miners and the gold price – since 2004



Source: Bloomberg

***Chart note:** I've highlighted the reasons for the divergence before. Essentially, some miners are poorly run businesses that spend too much money on digging in the hope that a high gold price will save them. They traded at a premium to fair value in the pre-ETF world and were a proxy for physical gold. Once investors could buy the metal via the stock market, that premium evaporated. It's now become a discount and it's too low. Gold mining shares are cheap if we assume the next five years sees an average gold price above $1,000. Some will die, but this index will recover once the dust settles. Don't be too brave and focus on the good stuff.*

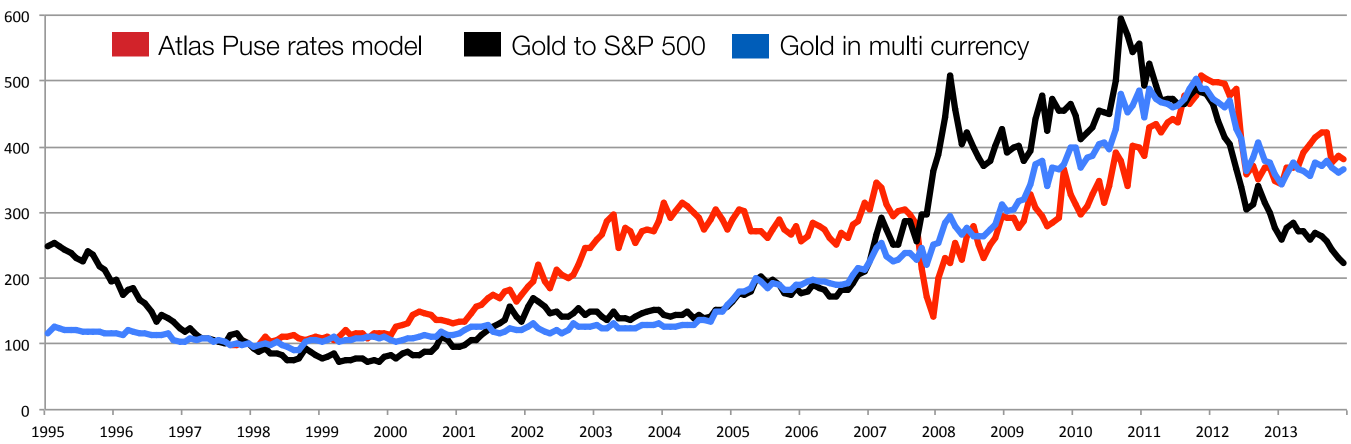
I don't make stock recommendations and stick to a macro perspective. The miners are extremely volatile and too much speculation in the 3x products is probably the cause of that. I believe the best companies have bottomed in this sector, but the big win will come from buying the lousy ones when this bear hibernates.

Gold core models

It's high time we looked at the gold thermometer. It was downgraded to neutral early last year and has been in bear mode since the April 2013 taper tantrum. US real long-term interest rates rallied from 0.3% to 1.5%. They are currently back below 1% as inflation expectations have drifted lower; oil is the key driver of that.

A quick reminder. The Atlas Pulse core models drive the thermometer. They are the 35 month trends of the gold price in global money, the gold to S&P ratio and real interest rates. All three are currently in bear mode so I have no good reason to upgrade the thermometer just yet, despite the fact that a significant bear rally looks inevitable.

The Atlas Pulse Core models – since 1995



Source: Bloomberg, Atlas Pulse

***Chart note:** The strength in equities is unhelpful for gold. Allocators have no incentive to push money into gold whilst it's not working. The multi-currency gold price is surprisingly stable. We haven't seen a new low so far this year. We mustn't confuse a dollar rally with gold weakness. Finally our rates model is indecisive. Real rates don't know whether the financial system is normalising, in which case they rise (bad for gold), or the whole equity bull market is a charade and inflation expectations shoot higher along with bond yields. The latter point is a complex relationship as I highlighted last month. The important point to remember is that long-term breakeven rates (inflation expectations) are four times more important than bond yields for the gold price.*

The miners won't perform until gold turns, but the value is such that they are a long-term buy. However, it is for the stock market to decide when that turn comes.

As an equity bull market develops, there becomes a clear divide between the winners and the losers. The winners today are technology, healthcare and various consumer stocks whereas the losers relate to commodities and emerging markets.

This may come as no surprise but the point is that this won't change in any major way until the whole market snaps. Whilst the losers chug along, under-performing the market but still breathing, all is well. However once the losers start losing real money, the underlying health of the market starts to wane.

With commodities in crisis, this process has begun. The winners could carry on for another year or so, but that's just a guess. Over time, more stocks will become losers. Investors will sell them and buy companies that are doing better. Thus in the late stages of a bull market, the winners overdo it and become richly valued. At that point, it's game over and the bear market begins.

Once the bear is complete, the losers will rally hard from deeply distressed levels. In 1932, the losers rallied by 256% in first three months of the turn, and in 2009, by 150% in just two months. This is the time to own the bad stuff. Gold miners, and commodity stocks in general, will surely be part of this charge at the end of the next bear market. But the next bear hasn't even begun, but it will probably do so at some point in 2015.

On a tactical basis, gold miners will follow gold. They are already too cheap but they may continue to fall with gold. If you do decide to buy them now, stick to the highest quality names. The clue is that they are profitable and have no debt. Don't buy the dross until the end of the next bear market in equities.

Short-term technicals

The gold price briefly re-tested the lows following the Swiss No vote. What appeared to be bad news led to a continuation of this bear rally. It could be good and make it all the way to $1,350 because the shorts are high. Furthermore, the season from now until Easter is traditionally bullish. If I had to make a guess, I'd say $1,350 by Easter. That's just a guess. If you are in doubt, follow the thermometer which remains in a bear market.

Gold in USD – past year

Source: Bloomberg

Chart note: *The recent price action tested the low at $1,150 and made a decisive break higher. The red line is the first level of resistance and white, the second. A 20% move takes gold just shy of $1,350. A break above that will signal a turn. If that happens, the thermometer will automatically move to neural. I suspect $1,250 will also prove to be challenging.*

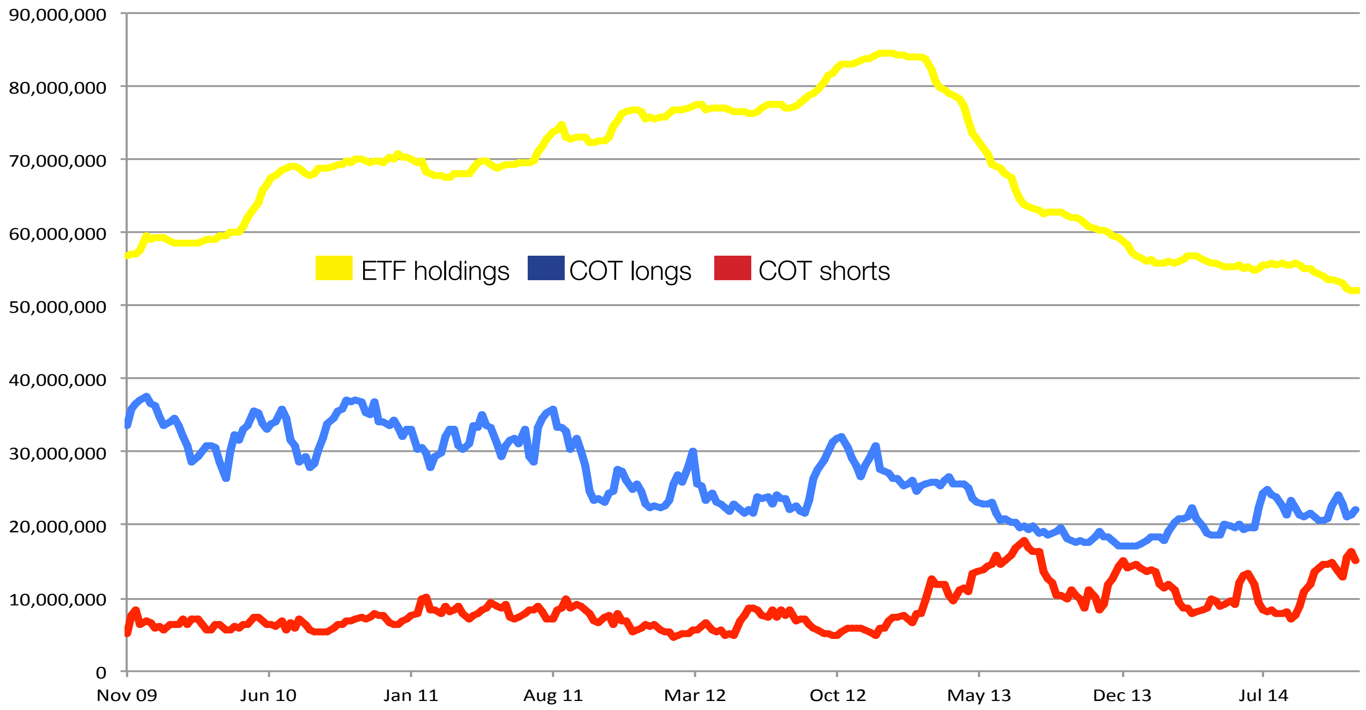
COT, flows, 3x and sentiment

COT stands for commitment of traders; it is the data series from the Chicago exchange that shows the positioning of speculative, as opposed to commercial, investors. Those are typically hedge funds.

ETF stands for exchange-traded fund. These hold physical gold and silver and are mainly traded by institutional and retail investors. The number of ounces of gold or silver that they hold is reported on a daily or weekly basis. All holdings are shown in million ounces (MOZ) on a like for like basis. The ETF movements tend to be slow, the COT longs faster, whilst the COT shorts move very quickly.

3x refers to the leveraged exchange-traded notes that are used by investors to express a strong view. The daily returns are 3 times (hence 3x) the daily percentage move of the underlying asset either long or short. These funds are highly speculative.

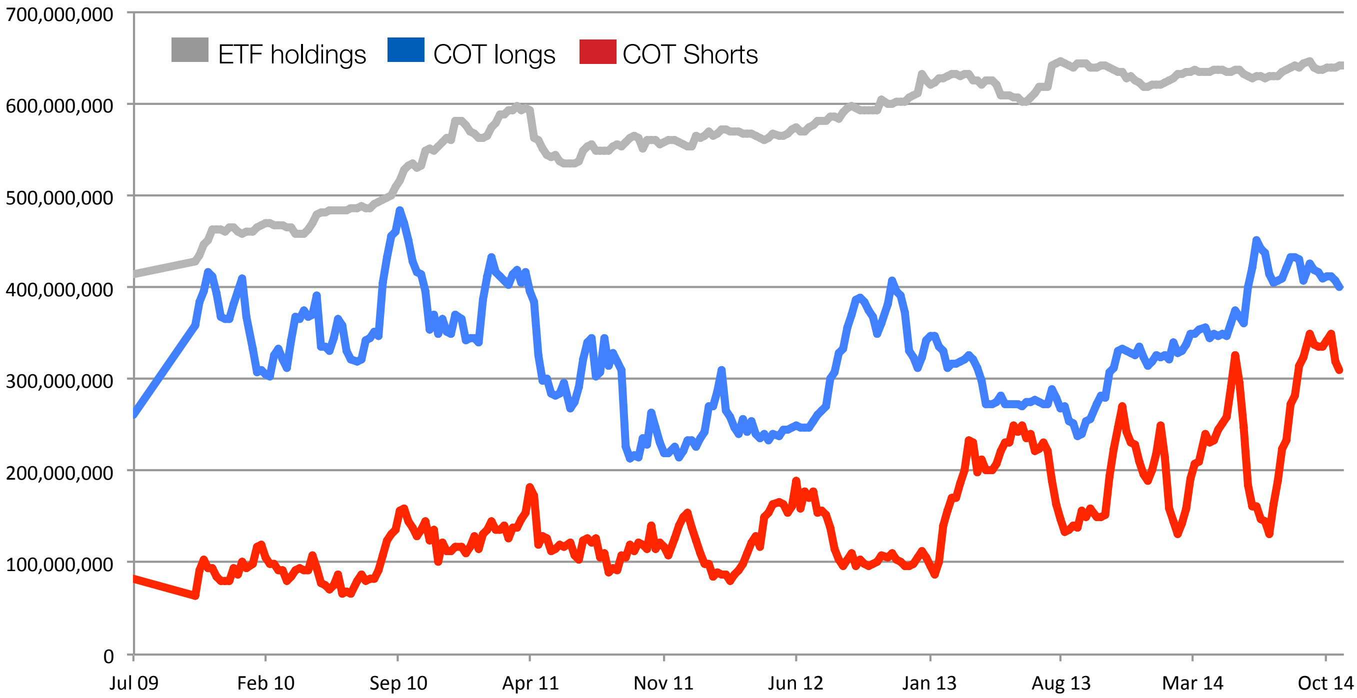
Gold COT and ETF flows – past five years



Source: Bloomberg

Chart note: *The shorts have started covering from high levels, but the red line shows how they have been committed in their cause. The blue longs are still in the game but haven't changed their view. The ounces from the ETFs trickle out. Russia bought them last month, but they are running down their reserves so we can't depend on forever. Less selling combined with short covering will see gold challenge $1,350.*

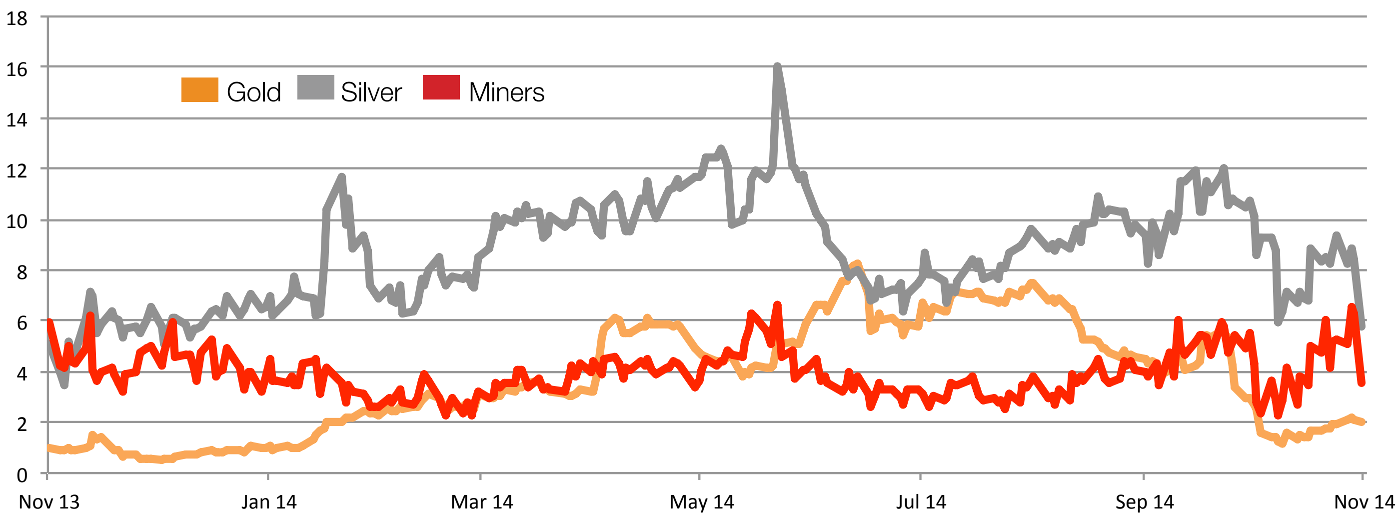
Silver COT and ETF flows – past five years



Source: Bloomberg

Chart note: *Billy Bob, our stereotypical silver stacker from Arkansas, refuses to sell; you have to admire him. He sees silver not only as an asset, but as a religion. The shorts are high, extremely high, and this short covering rally will shake the apples out of the tree. Remember the Atlas Pulse choke point? This is where the ETF purchases break even. That's at $17.70. I suspect that level will provide significant resistance.*

3x in gold, silver and the miners – past year



Source: Bloomberg

Chart note: *The gold bulls are few and far between; they have risen from low levels but not by much at just two times bulls to bears. The hot money is still convinced that greater upside is offered from silver and the miners and they continue to ignore gold. They are conceptually right, but maybe too early for the final turn. It's encouraging that they have fallen since the summer.*

Quite simply, gold is a good bet at current prices as a long-term investment. It may fall over the next year or so, but if I ran a central bank that had excess cash and not enough gold, I would be instigating my accumulation programme now.

A multi-blockchain world

I believe we are entering a multi-blockchain world. There are 65,000 equities in existence, 180 currencies (Wikipedia), a few dozen liquid commodities, hundreds of thousands of bonds and millions of websites. How many blockchains will there be?

I don't know the answer but I think it will be very much higher than most people think. In fact, most people haven't considered such a question but the more you learn about the potential for this technology, the more it becomes apparent that these things will breed like flies. So far we've seen 500+ cryptos launched, most of which don't serve a purpose. One is worth $5 bn, two dozen are credible ideas with values in the millions whilst the rest are just for fun.

Garrick Hileman, an economic historian at the London School of Economics, made the point that 4,000 alternative currencies existed before bitcoin came to fruition. He went on to say that bitcoin is different. It is the first with a global brand and was a truly new innovation. The press love it because of the drama that surrounds it such as Satoshi Nakamoto, the Silk Road and Mt Gox. Its predecessors generally failed because they were killed off by regulation, technological change or a lack of demand.

Applying this to bitcoin, the decentralised nature of the blockchain cannot be shut down. Regulators can attack the touch points where bitcoin meets fiat money, but with 6,500 live copies of the blockchain running around the world, they will struggle to kill it; they can only slow it.

As for technological change, bitcoin is vulnerable. It's true that a raft of core developers are constantly upgrading the software, but now the rabbit is out of the hat, a new and better idea will surely come along. There are too many next generation Bill Gates types around that will make this more likely than not.

Finally lack of demand. The need for crypto is huge, but most people just don't know why. It may not be bitcoin, but electronic CASH is a must have for the future growth of the Internet. Today, it is solely bitcoin.

Online cash and online banking couldn't be more different. Online banking, Visa, MasterCard and payments aren't online at all; they are merely accessed online. Modern banking is essentially a huge leap forward in the development of the cheque. It's progress and it works, but it just isn't cash.

If I buy Dominic Frisby's excellent book on bitcoin from Amazon… ok bad example because Amazon are really good at making the process seamless for registered users (they're in the minority).

If I buy Dominic Frisby's excellent book on bitcoin from its publisher, Unbound, I have to open an account, sign in, handover personal details and so on. A few minutes later, the book will be mine, at least in electronic form.

A web-cash transaction would entail clicking on a link, handing over some web-cash (such as bitcoin) and downloading it there and then.

Does it matter who I am? Does it matter where I live*? Do I need a username and password? No. None of it matters.

I just want to read Dominic Frisby's truly enjoyable book. I can do that in a bookshop without the drama and pay by fiat cash and that's it, so why is the current system so intrusive and cumbersome?

***For a hardback copy, I accept that an address would smooth the process.**

When I asked the digital currency expert at the Bank of England why they couldn't launch SterlingCoin, he mumbled. Great guy. Up with events, but his face said it all. His boss, Marc Carney, tried to launch the Canadian Dollar online a few years ago but the project failed. Like all those before them, presumably they couldn't solve the double spending problem. Obviously if I own a Loony (Canadian dollar) in electronic form, I can copy and paste it. Now I have two dollars. The beauty of bitcoin was that this problem was solved as it can't be copied. Bitcoin solved the problems of centralisation and double spend in one fell swoop.

Imagine a world where the Canadian Dollar, the US Dollar, the Pound, the Yen and even the Argentinian Peso were available as digital cash. The simple way for their central banks to do it would be to fork the blockchain of (say) Litecoin, name it as their currency, and declare it one for one to the fiat equivalent. In other words the PoundCoin would be worth one pound and would be backed by the Bank of England. Suddenly they'd be no volatility to citizens and online transactions would become seamless.

The current account, as you know it, would no longer need to exist. Online payments would be virtually frictionless. The financial system would change beyond recognition and the role of banks would diminish significantly.

Imagine that I now buy Dominic Frisby's excellent book on bitcoin with pounds using SterlingCoin courtesy of the BoE. Unbound, the publisher, has no payment volatility and I enjoy a transaction that takes a moment. Fees are minimal. No one has my data. Unbound (I'm sure they're good folk) won't have my email address with which they can promote some other book. It would be a better world.

My rant continues.

Facebook is valued at over $200bn. That's fine as that's what the financial projections see in the road ahead. Bubble? Maybe, but good luck to them. At a higher level, aggregate profit margins mean revert, just as oil does against gold. US margins are currently high by historic standards; a point that is well known and well flagged. Margins will come down but why?

There are two root sources of the margin boom. One is cheap financing whilst the other is Silicon Valley. This fancy tech is great, but they are profiting from our data. Personally, I use it and tolerate it, but I also hate it. To clarify that point, I love the services they provide, but hate the potential repercussions of my data becoming a source of value to them.

Maybe, just maybe, a blockchain could supersede Gmail, Yahoo, Facebook and so many more. Tony Blair famously described a 'stakeholder' society. He meant that organisations acted in the interests of all stakeholders whether they be customers, employees or shareholders. Quite socialist but I finally get the point. Blair may not realise that this may actually happen for entirely different reasons, but it will.

Let's take Facebook as an example. It's great for friends and family, but the profit machine is sucking our souls. It enjoys $11bn of revenue that is growing rapidly. That's good news for them, but their costs have ballooned ever since they grew up and became a public company. A few years ago, they used to manage the system for a few hundred million dollars, whereas now, it's around five billion dollars per year.

Imagine a blockchain called Facechain. They launch a coin, facecoin, do a bit of development to get the new social network going but then hand it over to the open source community. The nutters, like me, sign up as customers. The miners create facecoins and manage the blockchain. The developers earn facecoins in proportion to their contribution.

When I post a picture of my trip to Moscow (five star hotels are £100 per night), I send a small amount of facecoin to validate my transaction (say 0.1 pence equivalent). The network then recognises me. My transaction creates velocity within the ecosystem. Add thousands of Atlas Pulse readers, and before you know it, there's a network.

New users come in. More transactions make facecoin worth more. Developers are now making money. The miners get competitive so the network is secure. Developers work harder. More people join and so on. The network effect carries it forward. In my attempt to answer how many (effective) blockchains there will be, I ask how many business models this space will take down.

In this regard, so many have so little imagination. The bitcoin space constantly attacks Western Union. I say to them, you are setting your sights far too low.

Remember that Janet from the Federal Reserve and Marc (George Clooney) Carney from the Bank of England will one day put their currencies on line. It's not if, but when. At that point, the younger generation will wonder why a current account at a bank ever existed in the first place.

A coloured coin transaction

A former hedge fund manager, Adam Cleary, has launched bullionbitcoin.com. I tried it last week and it was pioneering stuff. I sent them 0.1 BTC, which was around £25, and I now have a small slug of gold in a vault in Guernsey. He's essentially replicated the ETF gold model within the bitcoin protocol. I sort of understand what happened so please forgive me if I have made a mistake.

- I sent 0.1 BTC to Bullion Bitcoin Ltd (BBL).
- I downloaded a Sparkbit wallet and gave BBL my address.
- BBL bought some gold on my behalf.
- BBL sent 0.0001 BTC to my Sparkbit wallet address. The reason that 0.0001 BTC was sent is that it is the minimum priority transaction size that is absorbed in fees. If it were lower, the miners might have ignored the transaction and so it would have taken ages to register. Since it was 100% fees to them, the miners grabbed it and prioritised the transaction so it happened quickly. 0.0001 BTC or 4 cents was sent to my wallet but the miners kept all the value.
- BBL accompanied the transaction with a technical message over the blockchain.
- Sparkbit recognised that message and added 2.95 hundredth's of a troy ounce of gold to my wallet.
- I now own some gold, BBL has 0.1 BTC, the miners have 0.0001 BTC and the blockchain has a message validating our contract for the rest of time.

This is the first 'coloured coin' transaction that I have ever done. It's fascinating. Whilst it will take time for people to trust services such as this, I see great potential. This transaction effectively occurred outside of the financial system and I recommend that you try it for yourself.

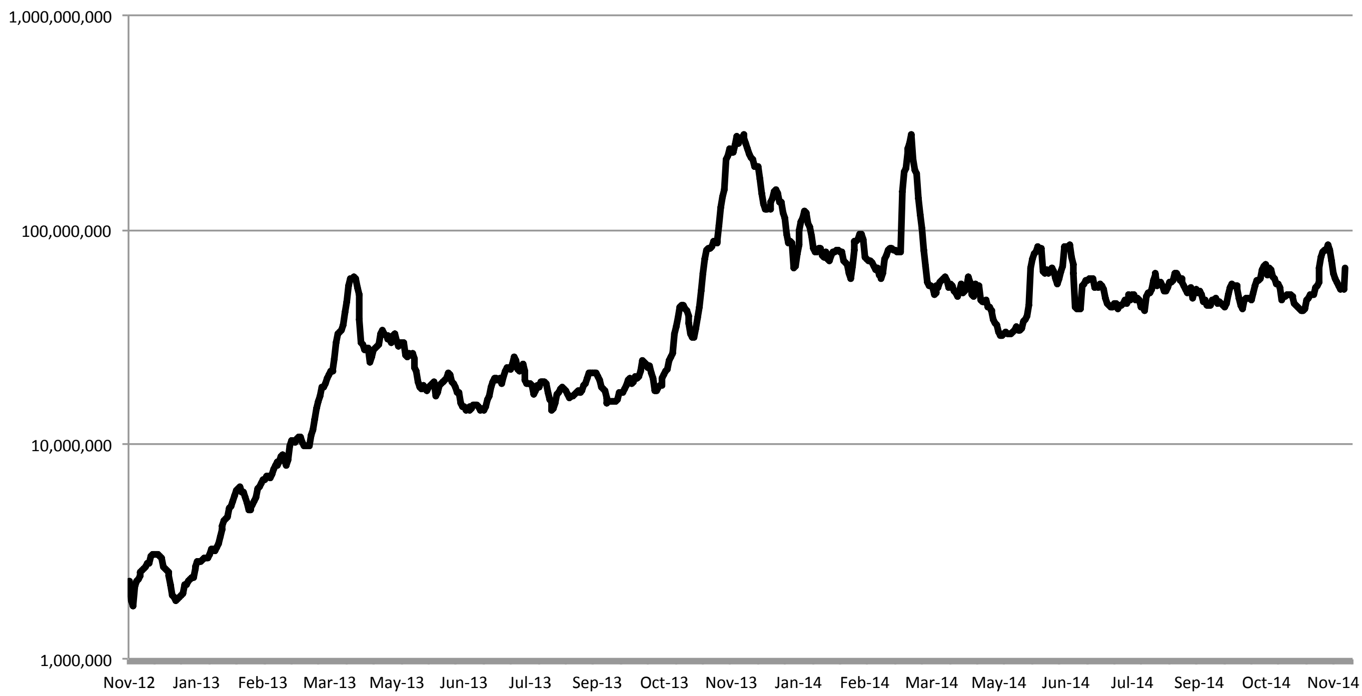
Network statistics

Readers will know that I believe the economics of cryptos are not dissimilar to a simple helicopter; the faster the blades spin, the more the price rises. There are other drivers such as valuation, inward flows from fiat and miners' sales, but the long-term price will be a function of real usage. Blockchain.info have attempted to calculate the daily spend of bitcoin. The complexity comes from the change algorithm which varies between wallets.

When you spend bitcoin, it is unlikely that you have the correct denomination. For example you wish to pay 1 BTC and have 10 BTC in your wallet, your 10 BTC could be lots of small pieces or a single large piece of bitcoin. If you don't have a 1 BTC piece, a change transaction has to occur. The software may take a (say) 3 BTC piece from you, send 1 BTC to the recipient and pay back 2 BTC to you as change. In some wallets, such as Blockchain.info, that comes straight back to you. However in others, it goes to a brand new address which is captured by your wallet making it hard to track.

The impact of change is that total output volume overstates spend by approximately six times. Blockchain don't disclose what they are measuring in the next chart, but state that they have tried to solve this problem. Crypto Composite are also working on this so, before too long, I'll be able to validate their work. As things stand, this chart is the current best estimate of how much was spent each day over the bitcoin network in dollar terms.

Bitcoin daily dollar spend – past two years – log scale



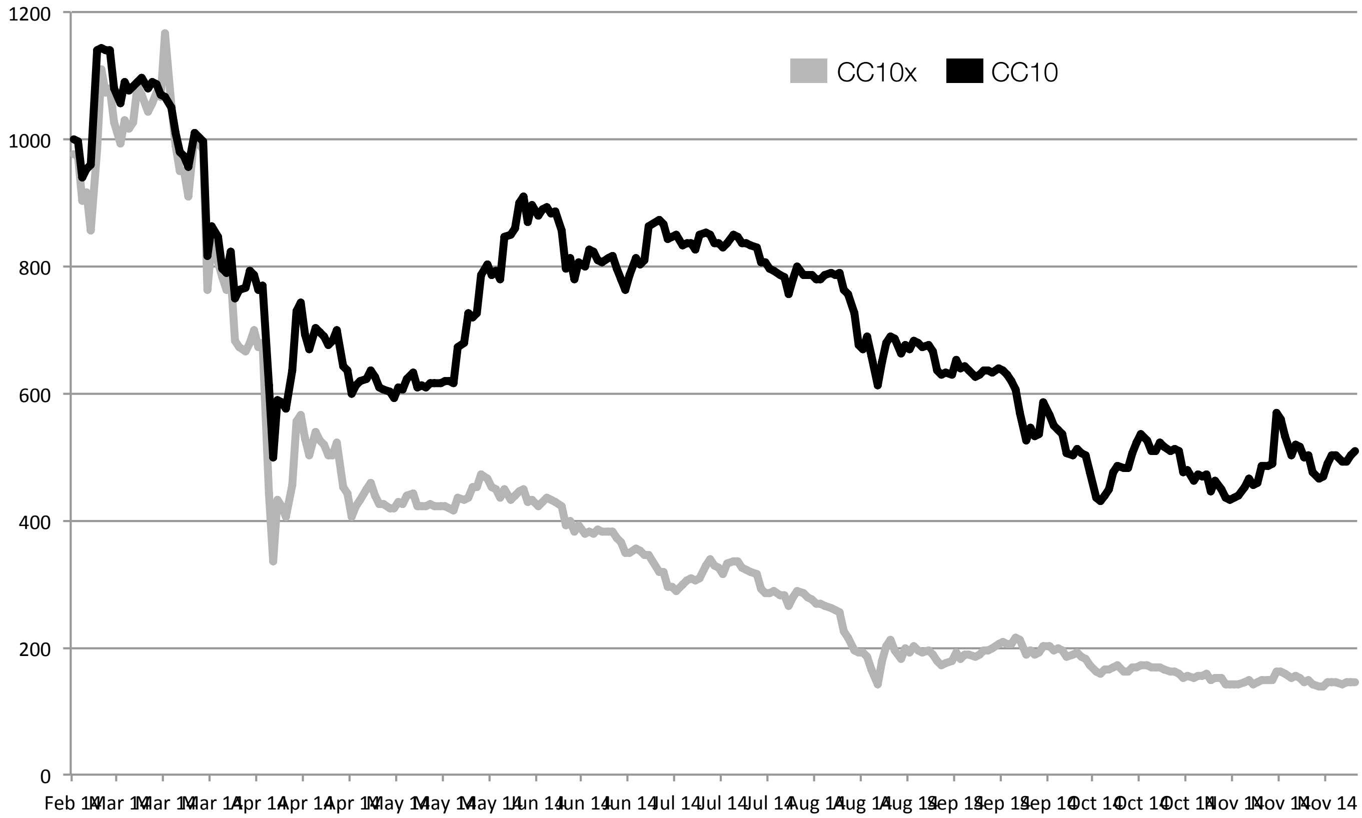
Source: Blockchain.info

Chart note: *Over the course of 2013, bitcoin's daily spend rose from just over $1 m to $100m. That's growth! Twelve months on, the network is approximately the same size as it was then, but it's good news that it hasn't contracted during a tough year. The banks have stood in its path. There have been various scandals. Apple threw in a grenade when they pulled wallets from their store. Despite all of that, bitcoin is alive and well. Growth in the network will lead to higher prices.*

Under the surface, the altcoins are no longer deteriorating relative to bitcoin. I have little doubt that more money will be made here because the catch up trade will be so vast. Altcoins tend to be valued between $1m and $100m. If an altcoin managed to created a network, the first 50 to 5,000 times will be on the house, and that's before the real money is made. People say altcoins are risky, but on a risk vs reward basis, they beat Gilts.

The CC10 and CC10x indices

The CC10 is like the S&P 500 for cryptos. It is 95% bitcoin due to its dominance. The CC10x excludes bitcoin so is more representative of Litecoin, Peercoin and Dogecoin.



Source: Cryptocomposite.com

Chart note: *I believe the low point for Cryptos came on the 18th August 2014. That was the trough for the CC10 versus the CC10x. The altcoins stopped dying relative to bitcoin from that point. They aren't rising but the rallies tend to be monstrous when they come. Think about what may happen to the miners at the end of the next bear market in equities; a similar logic applies here.*

Looking at the CC10 chart which is dominated by bitcoin, we've got a pattern of rising lows. Volatility is in the 60s, which is low for this space. The index is on the verge of turning positive using my favourite two moving averages, 34 and 46 days. 2015 will be a good year for cryptos.

Summary

Gold is being avoided by the hot money and institutional investors continue to sell. However, whenever things get bad, a big central bank seems to step in. Do they think gold is a good bet below $1,200? It seems so. The length and depth of the rest of this gold bear market hinges upon the willingness of the central banks to buy in size. Now the shorts are being squeezed. A rally could be as good as 20%. Here's hoping.

Silver and the miners are where the speculation is rife. The free lunch from these groups is only true when gold is rising and the relative value is being realised. The gold to silver ratio has swung between 72 and 78 in the past few hours. The 30 year average is 65. Cheap starts at 80, but my view is that if Billy Bob starts selling, we'll see 100. That means $1,000 gold equates to $10 silver. The best gold miners are already too cheap. Those with a strong balance sheet and low production costs will ride this storm. They are a long-term buy.

Cryptos have had a bad year, but much has happened beneath the surface. Developers have been working hard and I suspect 2015 will see a steady roll out of excellent new ideas. Once the public see the benefits, they will come in flocks and the forces will become overwhelming. When I started writing about cryptos this time last year, I predicted a 65% to 85% bear market, which turned out to be true. Ask me the same question today and I would forecast a new all time high in 2015. I can't back it up, but am confident that great things will happen.

The gold thermometer remains in a bear market (they're coming back).

The Crypto thermometer is neutral (it is what lies over the hill that will make us victorious).